

General Information Letter: Deferred compensation is "paid in this State" to the extent paid for services for which the ordinary compensation was "paid in this State."

December 5, 2001

Dear:

This is in response to your letter dated October 23, 2001 in which you state the following:

I have a client that was an Illinois resident, but during 2001, became a California resident due to a change in employment. He is receiving bi-weekly severance pay from his Illinois employer while a resident of California. I would like to know if the severance wages are considered taxable by the state of Illinois for the period that he is a California resident? Please provide me with a copy of the law or court cases that would support your answer.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Regarding the allocation of compensation paid to nonresidents for Illinois income tax purposes, Section 302(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) states in part:

All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment ... shall be allocated to this State.

IITA Section 1501(a)(3) defines the term "compensation" to mean wages, salaries, commissions and any other form of remuneration paid to employees for personal services. The Illinois Administrative Code further describes the statutory definition of compensation in 86 Ill. Adm. Code 100.3100(c):

The name by which remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, and pensions and retired pay are compensation within the meaning of the statute if paid for services performed by an employee for his employer.

86 Ill. Adm. Code 100.3100(d) states:

Remuneration for personal services constitutes compensation even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them, so long as such relationship existed when the services were rendered.

Pursuant to these provisions, severance pay must generally be considered "compensation" for purposes of the IITA. As such, severance pay is taxable in Illinois if "paid in this State" under IITA Section 302(a).

86 Ill. Adm. Code 100.3120(a)(1) states that compensation is paid in Illinois if:

- (A) The individual's service is localized in Illinois because it is performed entirely within Illinois;
- (B) The individual's service is localized in Illinois although it is performed both within and without Illinois, because the service performed without Illinois is incidental to the individual's service performed within Illinois; or
- (C) The individual's service is not localized in any state but some of the service is performed within Illinois and either (i) the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within Illinois, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Illinois.

86 Ill. Adm. Code 100.3120(b) provides specifically as to whether compensation paid for past service shall be considered paid in Illinois.

Where compensation is paid to a nonresident for past service, such compensation will, for the purpose of determining whether and to what extent such compensation is "paid in" Illinois and is allocated to Illinois under IITA Section 302(a), be presumed to have been earned ratably over the employee's last 5 years of service with the employer ..., in the absence of clear and convincing evidence that such compensation is properly attributable to a different period of employment ... Compensation earned in each past year will be deemed compensation paid in Illinois if the individual's service in such year met the tests set forth in [100.3120(a)].

In conclusion, when applying the above provisions in this case, your client's severance pay received while a resident of California is taxable in Illinois if such compensation is considered "paid in Illinois" pursuant to 86 Ill. Adm. Code 100.3120(b). Enclosed please find a copy of the above-cited Sections of the Illinois Administrative Code.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items one through eight of 86 Ill. Adm. Code 1200.110(b). Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney - Income Tax